In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 933

HENDERSON CLAY PRODUCTS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This case involves the computation of the taxpayer's percentage depletion allowance and, more particularly, the application of pertinent Treasury Regulations. The decision below is plainly correct and the conflicts asserted by the taxpayer are non-existent.

The taxpayer is an integrated miner-manufacturer which owned ball clay deposits in Texas. During the taxable years, it was engaged in mining the clay and using it to make brick for sale. (Pet. 31.) As a miner, it is entitled, under Sections 23(m) and 114(b)(4)

of the Internal Revenue Code of 1939, to a percentage depletion allowance in the amount of 15 percent of its "gross income from mining" (subject to a net-income-from-mining limitation). In *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, this Court interpreted the statutory definition of "mining" and held that an integrated miner-manufacturer's "gross income from mining" must be constructively computed by determining its gross income from the mineral at the stage where it first becomes fit for industrial use or consumption.[1] In terms of the present case, this means that the taxpayer's "gross income from mining" is that portion of its gross income which is attributable to shredded ball clay (which is of walnut size). The pertinent Treasury Regulations[2] provide methods for making such a computation. As applied here, they provide for use of the representative market price of shredded ball clay of like kind and grade to the taxpayer's, if there is such a price; and, if not, for the use of a proportionate profits formula under which the gross income from mining is taken to be that portion of the gross income from the sale of brick which the costs of mining bear to total costs.

This case, however, presents a further complication: While there was a representative market price for shredded ball clay based upon sales by Kentucky-Tennessee miners, that price was $10.50 per ton

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[1] This explanation of *Cannelton* was reiterated in *Riddell* v. *Monolith Portland Cement Co.*, 371 U.S. 537.

[2] Treasury Regulations 118 (1939 Code), Sec. 39.23(m)-1(e)(3).

whereas the sales price (per ton) for the taxpayer's finished brick averaged $8.75 over the four-year taxable period. (Pet. 30, 31.) The explanation for the higher price of shredded clay is that the market for it is small compared with the market for brick and its production and sale entails expenditures for management, advertising and research which are not required when the clay is used to make brick. (Pet. 34.)

Under these circumstances, the court below held that the taxpayer's "gross income from mining" must be computed by the proportionate profits method, rather than by use of the market price of shredded clay. As the court explained (Pet. 39, 46), the Regulations were not intended to permit use of a fictitious gross income from mining which is greatly in excess of actual gross income from both mining and manufacturing and which would allow the taxpayer to deplete costs of management, advertising and research which it did not incur; instead, the Regulations provide a reasonable technique for segregating the mining and manufacturing activities of an integrated company.

1. The decision below is correct. There is plainly no basis for taxpayer's suggestion that the Regulations and this Court's decisions in *United States* v. *Cannelton Sewer Pipe Co.*, *supra*, and *Riddell* v. *Monolith Portland Cement Co.*, 371 U.S. 587, support the anomalous proposition that a taxpayer's "gross income from mining" may include gross income which it never realized. Both *Cannelton* and *Monolith*

held, of course, that the "gross income from mining" of an integrated miner-manufacturer must be constructively computed with reference to the mineral at the first stage at which it becomes fit for industrial use or consumption. But no question was presented in either case as to how that computation was to be made. And to interpret the Regulations as taxpayer urges would obviously distort their purpose: to approximate "gross income."

2. Equally without merit is the taxpayer's complaint that it has not been given an opportunity to offer evidence on the issue and that the court below therefore failed to follow *Byrd* v. *Blue Ridge Cooperative*, 356 U.S. 525 (a damage suit for personal injuries). As the taxpayer's own argument demonstrates, the issue is not a factual one.

3. Taxpayer errs in asserting (Pet. 16-21) that the decision below is in conflict with *Hugoton Production Co.* v. *United States*, 315 F. 2d 868 (C.Cl.), and with the prior decision of the court below in *Alabama By-Products Corp.* v. *Patterson*, 258 F. 2d 892, certiorari denied, 358 U.S. 930. Those decisions are pertinent here only in the sense that they also involved applications of the Regulations. Neither case, however, involved a situation where the taxpayer was claiming a "gross income from mining" in excess of its actual gross income from both mining and manufacturing.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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